Supreme Court, U.S.
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No. 96-1491

In the Supreme Court of the United States

OCTOBER TERM, 1996

JOSEPH CUSIMANO, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTIONS PRESENTED

1. Whether petitioner's trading in securities on material, nonpublic information received from a corporate employee, who had misappropriated that information in breach of his fiduciary duties to the corporation, violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, and thus constituted insider trading under Sentencing Guidelines § 2F1.2.

2. Whether, in determining petitioner's sentence under Sentencing Guidelines § 2F1.2, relating to insider trading, the courts below correctly found that the information petitioner traded on was both material and nonpublic.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-12) is reported at 97 F.3d 663. The opinion of the district court (Pet. App. 15-18) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on October 4, 1996. A petition for rehearing was denied on December 17, 1996. Pet. App. 13-14. The petition for a writ of certiorari was filed on March 17, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

After entering a guilty plea in the United States District Court for the Southern District of New

York, petitioner was convicted of conspiracy to violate Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78j(b), and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. 240.10b-5, in violation of 18 U.S.C. 371. He was sentenced to 21 months' imprisonment, to be followed by three years of supervised release, and was fined $1 million. Pet. App. 19-27. The court of appeals affirmed. *Id.* at 1-12.

1. On August 18, 1995, petitioner pleaded guilty to conspiring with Charles Brumfield and others to violate Section 10(b) of the Exchange Act by trading in the securities of NCR Corporation, Digital Microwave Corporation, and Teradata Corporation while in possession of material, nonpublic information about the proposed acquisitions of those three companies by AT&T Corporation. Brumfield had misappropriated that information from AT&T, where he was a vice president of labor relations. Pet. App. 3; Gov't C.A. Br. 3-5. At the plea hearing, petitioner admitted that he had received material, nonpublic information from Brumfield regarding NCR, Teradata, and Digital Microwave securities. He also admitted that he made purchases in those securities based on the information obtained from Brumfield, and that he gave part of the proceeds of his transactions to Brumfield. Gov't C.A. Br. 4.

2. In the plea agreement, the parties stipulated that petitioner's base offense level was eight under Sentencing Guidelines § 2F1.2, the Guideline relating to insider trading. The parties expressly declined to stipulate to the total gain resulting from the offense, which would determine petitioner's adjusted offense level under Guidelines § 2F1.2(b)(1). Petitioner stipulated that $340,337 in profits that he earned from

purchases of NCR securities between November 15 and 20, 1990, should be included in determining the amount of the gain under Guidelines § 2F1.2(b)(1). Petitioner asserted, however, that an additional $642,888 in profits earned from trading in NCR securities on November 9 and 12, 1990, should not be included in determining the amount of the gain because those trades did not violate the securities laws. Petitioner's principal contention was that the information that he received from Brumfield and used in his trades on November 9 and 12 was neither material nor nonpublic. Pet. App. 4; Gov't C.A. Br. 5-6.

At petitioner's sentencing hearing, the government presented evidence that petitioner traded in NCR securities on November 9 and 12, 1990, after receiving information from Brumfield concerning a proposed acquisition of NCR by AT&T, and that petitioner knew that Brumfield had misappropriated that information. The evidence showed that, in March 1990, AT&T's corporate strategy and development group made a presentation to AT&T's executive management committee concerning a possible acquisition of NCR to strengthen AT&T's position in the computer industry. In August and September 1990, AT&T's investment bank analyzed several acquisition alternatives, including an acquisition of NCR. On October 17, 1990, the alternatives were presented to AT&T's board of directors. That same day, the board of directors selected NCR as the most attractive acquisition candidate and directed that a feasibility study be conducted. Between October 17 and November 7, 1990, AT&T formed several project teams to study the proposed acquisition. The teams included William Ketchum, who was Brumfield's immediate supervisor at AT&T. Gov't C.A. Br. 8-9.

In late September or early October 1990, an executive in AT&T's computer business unit asked Brumfield to evaluate the labor relations issues involved in integrating the workers in his unit with the work force of another computer company. Although the executive did not disclose the other company's name to Brumfield, Brumfield realized, based on the statistics he was provided, that the other company was NCR. Pet. App. 3; Gov't C.A. Br. 9-10.

One week after Brumfield completed his feasibility study, he and Ketchum attended a conference together on November 1 and 2, 1990. On the second day of the conference, Ketchum received a telephone call summoning him back to AT&T's offices for an emergency meeting with the president of AT&T's computer business unit. Ketchum's executive assistant told Brumfield that Ketchum had been called away for the meeting and would not return to the conference. Brumfield believed that the emergency meeting was a highly unusual and significant development, particularly since he had recently completed his feasibility study for the computer business unit but was not invited to attend the meeting. Gov't C.A. Br. 10-11.

On November 8, 1990, Brumfield was in Washington, D.C., to attend a meeting with union members. When Brumfield returned a telephone call to Ketchum that morning, Ketchum asked whether Brumfield had seen that day's *Wall Street Journal*. After Brumfield replied that he had not, Ketchum told him that the newspaper had reported that AT&T and NCR were discussing ways to combine their operations. Ketchum warned Brumfield not to speculate with others about the newspaper article during his meeting later that day. Ketchum's warning was significant to Brumfield because it was the first time

that Ketchum, who had a limited labor relations background, had ever directed Brumfield how to perform his job. Brumfield concluded that Ketchum's warning indicated that the newspaper story was true. Pet. App. 3, 16; Gov't C.A. Br. 11-12.

After speaking with Ketchum, Brumfield called petitioner, whom he had met in 1989 and with whom he had frequently discussed the possibility that AT&T might acquire a computer company. Brumfield discussed the *Wall Street Journal* article with petitioner and advised petitioner to read the article if he had not yet done so. Brumfield told petitioner that he believed that the contents of the article were true, and that AT&T would attempt to acquire NCR. Brumfield asked petitioner to purchase NCR call options for him through petitioner's brokerage account, and petitioner agreed. Brumfield said that he would contact petitioner shortly to tell him which series of call options he wanted to buy. Later that day, Brumfield called co-defendants William Mylett and Robert Allen and provided them with the same information. He also made arrangements with Mylett and Allen to buy NCR call options for him. Pet. App. 3-4; Gov't C.A. Br. 12-14.

The next day, November 9, 1990, Brumfield called petitioner to tell him which NCR call options to buy. He told petitioner to buy the options as soon as possible because he believed that the acquisition would occur quickly. Petitioner did not ask Brumfield for any money with which to purchase the options, and Brumfield did not send him any money. Gov't C.A. Br. 14-15.

That same morning, petitioner began buying NCR call options. By the end of the day, petitioner had purchased more than $52,700 worth of NCR call

options through his own brokerage account. He also purchased $18,000 worth of NCR securities through his brother's brokerage account. On the following Monday, November 12, 1990, petitioner purchased more than $27,900 in NCR call options through his brokerage account and more than $4,400 in NCR call options through his brother's account. Petitioner's purchases on November 12 accounted for more than 80% of the total market purchases for one series of NCR options and 50% of the total market purchases for another series. Later that day, petitioner confirmed with Brumfield that he had purchased the NCR call options that Brumfield had specified. Pet. App. 4; Gov't C.A. Br. 15-16.

After the publication of the *Wall Street Journal* article, AT&T accelerated its plans to acquire NCR, and the board of directors approved the acquisition on November 14, 1990. On December 2, 1990, AT&T publicly announced a tender offer to acquire NCR on a stock-for-stock basis at a price valued at $90 per share of NCR stock. After the announcement, NCR's stock price increased $24.75 per share on Monday, December 3, 1990, to a closing price of $81.50 per share. Pet. App. 4; Gov't C.A. Br. 16. Petitioner earned $642,888 in profits from trading in NCR securities on November 9 and 12, 1990, in his and his brother's accounts. Gov't C.A. Br. 6.

3. The district court ruled that petitioner's trades in NCR securities on November 9 and 12, 1990, constituted insider trading, and therefore were properly included in calculating petitioner's offense level under Guidelines § 2F1.2. Pet. App. 15-17. The court rejected petitioner's claim that those trades did not violate the securities laws because the information conveyed by Brumfield was neither nonpublic nor

material. The court observed that "Mr. Brumfield imparted information that was substantially more specific than that in [*The Wall Street Journal*] and that this information was highly material." *Id.* at 15-16. The court noted that the newspapers had reported only that the two companies "were discussing various scenarios for combining their computer businesses," and that "a decision of the two companies to somehow combine their computer operations would not be as likely to cause a rise in the price of NCR stock as would an acquisition by AT&T." *Id.* at 16. Since "Brumfield conveyed information that indicated a much higher level of probability than was publicly available concerning an event of great magnitude in the corporate life of NCR," the court concluded that "what Brumfield told [petitioner] was highly material," and that "[i]t cannot be doubted that any investor would want to know that insiders at AT&T were saying that an acquisition was going to take place." *Id.* at 16-17. The court further found that petitioner "knew he had obtained from Brumfield material inside information" and "knew that this information came from insiders at AT&T who had no right to disclose it." *Id.* at 17. The court accordingly ruled that petitioner's "relevant conduct for sentencing purposes includes all of his trading in NCR securities." *Ibid.*

4. a. The court of appeals affirmed. Pet. App. 1-12. It first noted that, "[u]nder the misappropriation theory of Rule 10b-5, insider trading occurs whenever a person trades while in knowing possession of misappropriated and material non-public information." *Id.* at 4. It then concluded, contrary to petitioner's submissions, that the district court had not erred in concluding that the information about the NCR acquisition that petitioner traded on was nonpublic,

material, and misappropriated from AT&T, and that petitioner acted with scienter. See *id.* at 4-5.

Concerning the nonpublic nature of the information, the court noted that Brumfield imparted information to petitioner "that was substantially more specific than that in the newspaper." Pet. App. 5. "[W]hile the newspaper reports listed an attempted acquisition as one possibility among many, Brumfield's statement to [petitioner] that 'AT&T was going to attempt to acquire NCR' was both more specific and more certain than any reports in the press." *Ibid.* The court noted further that Brumfield was well positioned to conclude that AT&T would in fact attempt to acquire NCR, because he had been asked to perform the labor relations feasibility study, and Ketchum had warned him not to speculate about the press reports. *Id.* at 5-6.

The court expressly stated that it "[did] not today hold that any predictions made by an insider can constitute the basis for insider trading simply because a tippee relies upon them and their source, and they subsequently come true." Pet. App. 6. The court observed that "here the statement made by the insider was qualified, supported, and credible." *Ibid.* It also explained that "Brumfield did not state that AT&T *would* acquire NCR," but rather, "on the basis of nonpublic data, that he *believed* that what he read in the paper was true, and that AT&T was going to be *attempting* to acquire NCR." *Ibid.* "[Brumfield] had private information that would support both of these remarks, and both of them were of great value to a would-be trader." *Id.* at 6-7.

The court further ruled that "[t]he trial court did not err in finding that the information imparted by Brumfield was material." Pet. App. 7. In reaching

that conclusion, the court expressly applied the test adopted by this Court in *Basic Inc.* v. *Levinson*, 485 U.S. 224, 238 (1988), that the materiality of a contingent and speculative event depends "upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." Pet. App. 7. The court first rejected petitioner's argument that the probability of AT&T's acquisition of NCR was low before his trades occurred. Even before those trades, "AT&T had hired an investment bank, outside counsel, and accountants to formulate an acquisition plan; AT&T management had conducted integration plans for an acquisition; and AT&T management teams were conducting discussions relating to an NCR bid." *Ibid.* The court then rejected petitioner's claim that the magnitude of the event was not high, noting that petitioner had not explained "why a $6 billion acquisition should not be considered an event of great magnitude." *Id.* at 7-8. The court also remarked that "the sharp jump in NCR's stock price after a formal acquisition announcement was made suffices to support a finding that the event in this case was one of major magnitude." *Id.* at 8.

Finally, the court of appeals ruled that "[t]he district court correctly found that [petitioner] misappropriated information." Pet. App. 8. The court explained that petitioner "acquired his information [through a breach of a relationship of trust and confidence] for he knew that his source, Brumfield, held a position of trust and confidence in AT&T," notwithstanding that Brumfield had never been told directly by anyone at AT&T that AT&T was planning to acquire NCR but had "concluded through his own

ingenuity" that the acquisition would be attempted. *Ibid.*[1]

b. Judge Meskill concurred in part and dissented in part. Pet. App. 11-12. He did not agree that petitioner's "trades on November 9 and 12 were criminal acts that should have been included in calculating his offense and fine level." *Id.* at 11. In his view, "even though some of the information relayed by Brumfield to [petitioner] was material, and some was non-public, none was both." *Ibid.* In particular, he concluded that Brumfield's predictions of an acquisition of NCR by AT&T "were based on false or thoroughly inconclusive information" and were therefore not material, *ibid.*, since "Brumfield could not state correctly that the acquisition attempt was going to happen at all," *id.* at 12.

DISCUSSION

1. Petitioner contends (Pet. 9-10) that his conviction for conspiring to commit securities fraud is invalid because the misappropriation theory does not constitute a proper basis for establishing criminal liability under Section 10(b) of the Exchange Act and Rule 10b-5. That issue is currently before the Court in *United States* v. *O'Hagan*, No. 96-842 (argued April 16, 1997). Petitioner therefore requests that the petition in this case be held for *O'Hagan*.

Petitioner pleaded guilty to the charge of conspiracy to violate Section 10(b), aware that the government's theory of liability for the predicate offense of

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[1] The court of appeals also found that petitioner had acted with scienter. Pet. App. 9. It further rejected his contention that the district court erred in enhancing his offense level for obstruction of justice (through perjury at the sentencing hearing) under Guidelines § 3C1.1. Pet. App. 9-10.

securities fraud was based on the misappropriation theory. Petitioner did not move to withdraw his guilty plea and did not, in the district court or on his initial appeal, challenge the misappropriation theory as a basis for his substantive criminal liability.[2] Both lower courts, however, treated the principal sentencing issue in this case—whether insider trading had been established with regard to petitioner's November 9 and 12, 1990, trades, such that petitioner's gain from those trades should be used to calculate his offense level under Guidelines § 2F1.2—as identical to the question of substantive criminal liability under Section 10(b). Moreover, the court of appeals reaffirmed its precedent that, "[u]nder the misappropriation theory of Rule 10b-5, insider trading occurs whenever a person trades in knowing possession of misappropriated and material non-public information." Pet. App. 4 (citing *United States* v. *Chestman*, 947 F.2d 551, 566, 570 (2d Cir. 1991) (en banc), cert. denied, 503 U.S. 1004 (1992)).

The Court's decision in *O'Hagan* may affect the court of appeals' resolution of the sentencing issue in this case, its treatment of petitioner's substantive criminal liability, or both. Accordingly, the petition in this case should be held for the Court's decision in *O'Hagan*, and then disposed of as appropriate in light of that decision. If the Court in *O'Hagan* upholds the misappropriation theory, the petition should be denied. If the Court rules in *O'Hagan* that the misappropriation theory is not a valid basis for criminal liability under Section 10(b), the court of appeals on

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[2] In a petition for rehearing presented to the court of appeals, petitioner asked that court to reconsider the validity of the misappropriation doctrine. Pet. C.A. Br. 2.

remand will be free to reconsider the sentencing issues as well as whether petitioner may assert an objection to his substantive criminal liability, notwithstanding his guilty plea and his failure to raise the issue on appeal until the rehearing stage.

2. Petitioner also contends (Pet. 10-17) that the courts below erred in concluding that the information he obtained from Brumfield and used in his trades in NCR securities on November 9 and 12, 1990, was material and nonpublic. The conclusion of the courts below that the tip petitioner received from Brumfield was based on material, nonpublic information is correct. It is also a fact-bound determination, based on a correct application of this Court's materiality test. Further review is therefore not warranted.

Materiality depends on the significance that the "reasonable investor" would place on the relevant information. *Basic Inc.* v. *Levinson*, 485 U.S. 224, 240 (1988). The materiality of information about a contingent or speculative event, such as a potential merger, "will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." *Id.* at 238. The question of materiality in any particular case is "inherently fact-specific." *Id.* at 236; see also *id.* at 240; *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 450 (1976) (although materiality "may be characterized as a mixed question of law and fact," materiality determination "requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact"). All the surrounding facts must be considered to

determine whether certain information is material; no particular event or factor is necessary to render merger discussions material. See *Basic*, 485 U.S. at 239.

The lower courts correctly applied the proper legal standards to the facts of this case. Petitioner argues (Pet. 14, 15) that the tip he received from Brumfield was merely unsupported speculation by a corporate insider, and that the court of appeals' decision will allow prosecution for insider trading whenever someone receives a prediction from an insider that happens to come true. But the court of appeals rejected the proposition that insider-trading liability could be founded on an unsupported prediction, and held that the tip here was supported (Pet. App. 6):

> We do not today hold that any predictions made by an insider can constitute the basis for insider trading simply because a tippee relies upon them and their source, and they subsequently come true. * * * We need go nowhere near such an extreme holding, for here the statement made by the insider was qualified, supported, and credible.

The court of appeals' conclusion that Brumfield's tip was based on material, nonpublic information is correct. Brumfield did more than speculate that AT&T would attempt to acquire NCR; he had substantial information beyond that reported in the *Wall Street Journal* about the possibility of an acquisition of NCR. Brumfield had been asked to conduct a study of the feasibility of integrating AT&T's work force with that of a computer company with the same vital statistics as NCR. Brumfield's supervisor had also taken the unusual step of warning him not to discuss a press report speculating about AT&T and NCR.

Pet. App. 5-6. Furthermore, Brumfield was aware that his supervisor had recently been called to an emergency meeting with the president of AT&T's computer services unit. Gov't C.A. Br. 10-11. Even though no one had told Brumfield directly that AT&T executives were actively pursuing a merger with NCR, Brumfield's access to corporate information obtained in the course of his employment duties enabled him to reach that conclusion.

Brumfield's inside information was material because there was a substantial likelihood it would have been considered significant by a reasonable investor and (had it been disclosed to the market) would have been viewed by such an investor as having significantly altered the "total mix" of available information. *Basic*, 485 U.S. at 231-232. For the information about AT&T's acquisition of NCR to be material, it was not necessary that the acquisition have been certain to take place or have been definitively authorized by the directors of AT&T. As petitioner recognizes, under *Basic*, information about a contingent event such as a possible corporate acquisition can be material even if that event is not certain to occur. The privately expressed view of a corporate insider that an acquisition attempt would be made, supported by knowledge of nonpublic events occurring within AT&T, was more detailed and definite information than could be culled by investors from public sources. And as the court of appeals observed (Pet. App. 7-8), a $6 billion acquisition is "an event of great magnitude," a point confirmed by the "sharp jump" (*id.* at 8) in NCR's stock price after the announcement of the acquisition. The lower courts therefore did not err in concluding that the information used by petitioner in this case was both material and nonpublic.

CONCLUSION

As to the first question presented, the petition for a writ of certiorari should be held pending the Court's decision in *United States* v. *O'Hagan*, No. 96-842, and then disposed of as appropriate in light of the decision in that case. In all other respects, the petition should be denied.

Respectfully submitted.

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